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Effects of International Monetary Fund Programs on
Effectiveness of National Governments

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Summary of the PhD thesis "Effects of International Monetary Fund Programs on Effectiveness of National Governments"

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Keywords: IMF programs; IMF reforms; conditionality; country ownership; government effectiveness; SWOT analysis; propensity score matching; difference-in-differences

The research paper titled “Effects of International Monetary Fund programs on effectiveness of national governments” aims to evaluate effectiveness of the governments participating in the IMF programs and to contribute to improvement of the IMF-government collaboration. The scientific approach looks at estimating IMF program effects in the context of the IMF recent reforms, by focusing on current challenges, in order to identify individual factors that can foster government quality, as well as to systemize the adverse effects of IMF participation seeking to increase awareness of domestic authorities.

The overarching reason for selecting this topic comes from the need to revalue the role of government considering its weak capacity to overcome the external turmoil, and to increase the importance of government regulation. As the recent financial crisis has evidenced shortcomings of market self-regulation. Thus, the current thesis is peculiarly relevant in a post-crisis period the one world faces today: a time, in which a profound apprehension of the functioning of regulative policies can bypass the improper rules made or overmuch left on shoulders of agents, operating in free-market, under the label of an ideal mistake-proof invisible hand.

In sum, the thesis is structured in seven chapters being recounted on 287 pages and has cited 468 bibliographical sources. The remainder of the paper reports main findings and conclusions by chapters.

Part I – Conceptual, Theoretical and Methodological Approaches

The **first chapter** provides stable perceptions about the concepts of efficiency and effectiveness analyzing views of economics, management and praxeology. The concept of effectiveness has been identified as the most appropriate to the scope of this thesis as it illustrates the capacity of an entity to accomplish tasks by achieving the proposed results Therefore, the remainder of the chapter is devoted to the analyses of the IMF program effectiveness by revealing the specificities of its evaluation. Hence, three specific problems related to the IMF have been identified, which are presented as follows: endogeneity; selection bias; and adverse effects. Those three issues hinder the assessment of IMF program effectiveness given the absence of a universal method to deal with them simultaneously.

Another issue in the evaluation of IMF effectiveness is that the programs lack an overarching goal. It has been disclosed that the IMF, after collapse of par value system, has gradually enhanced its goals by being involved in solving problems linked with economic growth, poverty and problems of good governance. The chapter has identified that the IMF program components, namely the liquidity and conditionality, as well as the various types of conditionality have different sway on economic variables. Thus, it has been decided to evaluate both the contemporaneous and two-year effects of IMF programs on government effectiveness.

The **second chapter** analyzes the IMF program effectiveness in regard with the goals of those programs and by further seeking to reveal a relevant approach for this thesis. Particularly, the analysis of employed methods has revealed that all of them possess shortcomings, yet the application of Propensity Score Matching in combination with the Difference-in-Differences estimator can significantly reduce the selection bias and extract robust results since the first one controls selection on observable variables, while the second one deals with selection on unobservable factors. Based on literature reference materials, an attempt is made to define the concepts of effectiveness and government effectiveness. To our opinion, the effectiveness is the accomplishment of the process with the desired outcome achieved. Thereby, we would define"government effectiveness" as the ability of the government to complete the program by achieving the targeted results. Hence, the final section of this chapter provides a comprehensive review on the assessment of government effectiveness both from national and international perspectives by discussing the objective and perceptive approaches. As a result, for our model we have preferred the index of government effectiveness measured by Kaufman *et al.* as an outcome variable. The three main reasons for validation of this choice are as follows: availability of cross-country data; capacity to capture complexity and multidimensionality of entire government; and low impact of estimated standard errors on the credibility of results.

Part II – Evolution of the IMF and Assessment of Its Recent Reforms

The **third chapter** of this thesis describes the IMF as a global financial architect and presents the evolution of its role and mission in the world economy. It evaluates the necessity of the IMF revitalization and the effectiveness of proposed reforms. The following issues regarding the credibility of IMF and its ability to safeguard global financial stability have been considered gradual polycentrism in the world and limited financial capacity to shoulder the responsibility of international lander of last resort.

The review of the IMF governance system has unveiled that it does not correspond to the reality and there is a problem of over-representation. Moreover, the current structure of 12 constituencies neglects the voice of developing countries and gives an absolute power of decision-making to the chairman of those constituencies. Meanwhile, different initiatives have been launched by the IMF within the period of it activities to increase its effectiveness and transparency and to meet the growing needs of its members, though the scholars considered them non-reasonable without implying major modifications.

Thus, the main problems of the IMF before crisis can be categorized as follows: search for new funding sources; governance reform; modification of its lending policy; and upgrade of its surveillance mission. The GFC has provided a unique chance to the IMF for its refinement. And it seems that the IMF has accepted the challenge by launching the IMF governance and quota reform in 2010.

Thus, the **fourth chapter** analyzes the reforms and major modifications that the IMF has proposed to carry out since the onset of the recent crisis by unveiling their role in the IMF refinement and enhancement of its effectiveness. The review of the governance and quota reform has illustrated that the IMF attempts to modify its structure and minor success has been achieved. But it is not satisfactory, as the U.S. still preserves its right of veto on major decisions, and the IMF Executive Board is still based on constituencies where the voice of its developing members is not considered.

Analysis of the novel facilities of the IMF shows that although the recipient countries have been satisfied by them, they still preserve a serious shortcoming. Particularly, it entails negative stigma since countries signing arrangement other than those with ex-ante conditionality are thought to have been rejected for not having sound policies and strong economic fundamentals. Ergo, IMF should take into consideration availability of the negative stigma and should refine them. The IMF has been successful in streamlining conditionality by eliminating structural performance criteria, which by many scholars have been considered out of the IMF mandate. Moreover, the IMF, in collaboration with the beneficiaries of concessional lending, has applied measures aiming to protect social sector. Specifically, during the crisis period IMF has employed measures that aimed at protecting the most vulnerable in the recipient countries, which are as follows: floors on social spending, cash transfers, social safety nets. They have been employed by the IMF within the concessional loans allowing governments to safeguard the social sector.

Yet, case studies from the EU argue that the IMF still preserves the austerity within the non-concessional lending.

This section reveals and discusses the reasons of debt crisis in four Eurozone countries by substantiating their decision to resort to the IMF. Thus, the IMF, since 30 years of interruption, has first dealt with the advanced countries and the first time in history has allowed the central bank of recipient countries to be involved in imposing conditionality. This collaboration gave the start to launching two regional initiatives: Vienna Initiative and Troika Group, by having flexible attitude towards the participants. The effects of those two initiatives chiefly have been evaluated as positive, which has been partially conditioned by the IMF commitment to the flexibility and the keenness to co-operate with other institutions. In sum, it illustrates the flexibility and reform-orientation of the IMF given that the changes are not crucial and do not cause reasonable modifications in the IMF management.

Part III – Estimation of IMF program effects on government effectiveness: novel approach to program initiation and frame of the IMF adverse effects on domestic economies

The **fifth chapter** is split into two sections, where the first section analyzes the IMF program initiation and implementation in two different regions: Latin America and Central and Eastern Europe. It reveals that the IMF, given the scope of its major shareholders, have designed different measures for those regions. Furthermore, it has been identified that political factors have significant sway on the design and implementation of the IMF programs. Thus the following three factors should be considered in an attempt to reduce non-compliance: political conflicts; after-election abolition and government orientation.

The second section conducts SWOT analysis to shed light on the recent collaboration of the four EU countries. It should be noted that the IMF has collaborated with them differently, since the crisis had different impact on their economies. As it has been discussed, the political factors matter during the implementation of the programs, since after initiation of the IMF programs the prime-ministers of Romania, Latvia and Hungary resigned. Thus, political conflicts and government instability are regarded as a threat and weakness for effective implementation of the IMF programs, which concerns Poland as well. Meanwhile, the strengths and opportunities of the four countries have been considered, namely the government's ability to negotiate the terms and to bring the programs to the end, as there is no program cancelled due to non-compliance. By comparing the implementation of the IMF programs by Romania, Hungary and Latvia (all of them have signed the Stand-By Arrangement), one can conclude that Romanian authorities have been more effective in implementing the conditionality. As regards to Poland, it has been in more favorable situation since the crisis hit lighter its economy, which is evidenced by the fact of approving the Flexible Credit Line with ex-ante conditionality.

The **sixth chapter** employs propensity score matching with regression-adjusted residuals combined with difference-in-differences estimator to evaluate the effects of IMF programs on government effectiveness. The sample covers data over 1996-2014 period from 119 countries being supported by 2,255 observations. Five hypotheses have been put forward and corroborated by obtained results, which suggests that the IMF programs have influenced positively government effectiveness both in the first and third year of program initiation, by improving the government effectiveness by 0.12 and 0.09 points respectively. These findings allow us to conclude that governments are more likely to implement prior actions, since the first tranche is conditional on it. Hence, it is suggested to incorporate governance-orientated measures within prior actions, as it contributes to the increase of quality by further fostering economic growth, as was discussed in the literature reference materials.

Furthermore, the sample has been split into two periods: before crisis and after crisis. The aim of splitting is to assess the effectiveness of the IMF programs regarding the government quality. The results claim that the post-crisis IMF program effects were stronger than pre-crisis ones at least twice. Particularly, the IMF programs have contributed to the government effectiveness after 2008 by increasing it in program initiation and after two-year period with 0.25 and 0.19 points respectively.

It should be mentioned that this research has limitations as well. Specifically, it does not distinguish between types of IMF programs, as it is assumed to have different sway. Another major improvement could be the inclusion of a regional dummy into the model to assess the region most likely to improve its government effectiveness. Finally, the econometric results in the thesis need to be handled with discretion, since the model has not distinguished between the effects of the IMF assistance, therefore effects of technical assistance and policy advice have been attributed to the financial assistance. Nevertheless, an attempt has been made to regress residuals considering WB assistance as a describing covariate for government effectiveness, the coefficient has not been statistically significant. It should be taken into consideration in further studies, seeking to combat the possible effects of WB assistance attributed to the IMF. All aforementioned limitations should be acknowledged and incorporated in the future studies.

Based on obtained results in the **seventh chapter** utility functions of the IMF and government have been revisited by incorporating the index of government effectiveness to make liquidity size conditional on it. The inclusion of such an index in program initiation stages is likely to improve non-compliance and decrease pressure from its major shareholders. This is conditioned by the fact, that public available index of government effectiveness would make vivid the bias of the IMF non-economically driven decisions, in the aftermath they would cease to be biased. The governments**,** in their turn, would be able to reduce negative signaling stigma of rejection, since the index would provide a chance to measure their probability of approval to a certain arrangement before applying. The inclusion of government effectiveness index in the program initiation stage along with the other influencing factors have been depicted by detailing the advantages and challenges of the adoption of a novel approach of program initiation.

Furthermore, the analyses of the IMF measures over the 2002-2015 period has revealed the following three typical measures that have been repeated the most: low budget deficit, low inflation and structural reforms (privatization and liberalization). The aim of this analysis has been to unveil the adverse effects that the IMF has on domestic economies by imposing pro-cyclical measures during the crisis. Therefore, a frame of adverse effects has been captured detecting theoretical impact of mostly employed measures of the governments. Particularly, the most common way to cut budget deficit are salary freezes, wage cups, pension cuts, which directly affect public sector. Ergo, it is advised to the governments to take into consideration the possible adverse effects of their policies and to negotiate with the IMF applied measures.

The research has a practical value, since it may facilitate identification of possible adverse effects of program participation for domestic authorities responsible for stabilization programs. In addition, our recommendations to include well-designed punishment instrument might be effective in rebuilding the IMF credibility and enhancing government effectiveness. Last but not least, the main tenets and findings of the thesis can be included in education process of Public Management and Political Economy, as well as International Economic Relations.